NATIONAL FORECAST DESCRIPTION

The Forecast Period is the First Quarter of 2007 through the Fourth Quarter of 2010

The U.S. economy ends 2006 like a lion, but starts 2007 like a lamb. After advancing by a subpar 2.0% annual pace in the third quarter of last year, real GDP posted a small rally in the last quarter, growing by 2.5%. On an annual basis, real output increased 3.3%, which is near its potential. This showing will not be repeated. The current forecast calls for output to slip to a 1.3% annualized rate in this year's first quarter. Real output is being held down by housing, software and equipment spending, and inventories. The housing sector has been a drag on the economy since the last quarter of 2005. It is expected to shave about 1.1 percentage points off real GDP in the first quarter. Software and equipment spending has been soft recently, and it is projected to reduce GDP by 0.2 percentage point in this year's first quarter. However, the biggest drag will come from inventories; it lops 1.3 percentage points off real GDP in the first quarter. The expected weakness during the first part of this year raises worries regarding risks to the forecast.

A major concern is the subprime mortgage meltdown. The signs of subprime market stress are evident on an almost daily basis. Over the past few months, over two dozen lenders have filed for bankruptcy, sought buyers, or ceased operations. Meanwhile, both delinquency rates and foreclosures have risen sharply. For example, delinquency rates in the subprime market rose to 13.3% in the fourth quarter of last year. In comparison, the prime-loan delinquency rate is only 2.6%. Foreclosure rates in the same quarter were 0.54% for subprime loans and 0.24% for prime loans. Subprime loans account for 13-14% of all outstanding mortgages. The subprime adjustable-rate mortgages (ARM) are the biggest worry. About two-thirds of these ARMs will "reset" in the next two years, raising monthly mortgage payments, which points to more foreclosures down the road. It also points to lower housing demand, which dampens starts. The ripples from the impact of the weak housing sector could spill over into other sectors. For example, the softer housing demand and falling consumer confidence could force households to curtail spending on durable goods.

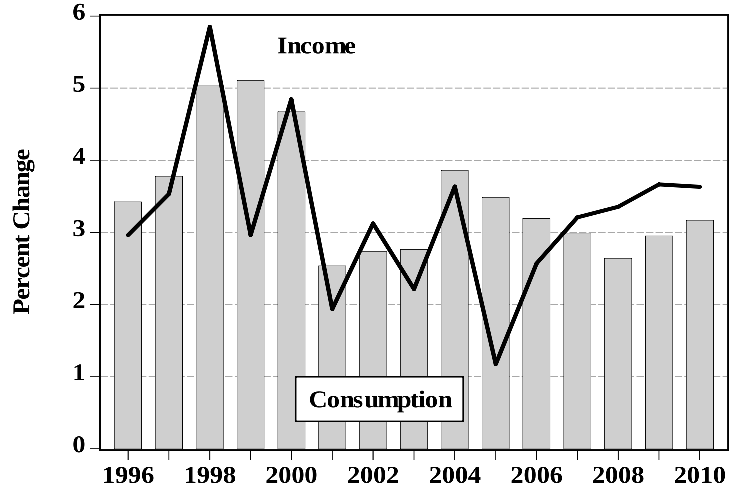
Another worry is inflation. Although energy prices are expected to stabilize, the tight labor market is expected to continue exerting upward pressures on wages. Wages are a major contributor to the core inflation rate. Improving labor productivity outlook will help, but not offset the negative impacts of rising wages. Despite the steady productivity growth, wage costs should accelerate from 3.1% this year to 3.5% in 2010. The core inflation rate averages about 2.2% per year. This will make the Federal Reserve's job interesting. Its problem will be more akin to the one faced by Paul Volcker than any seen by Alan Greenspan. The former Federal Chairman's tenure started with stagflation, a situation of runaway inflation and slow growth. Stagflation's back was only broken after the nation suffered a recession.

The U.S. economy is not expected to experience a recession over the next few years. This forecast assumes the Federal Reserve will not make any serious policy mistakes. After downshifting in the first quarter, real GDP growth should gradually move into higher gear. Specifically, it accelerates from 2.1% growth this year to 2.8% next year to 3.3% in 2009, and 3.1% in 2010. Likewise, U.S. housing starts also recover slowly, going from 1.413 million units in 2007 to 1.717 million units in 2010.

SELECTED NATIONAL ECONOMIC INDICATORS

Consumer Spending: Steady consumer spending should keep the economy advancing, even while the housing market retreats. Real spending is forecast to grow at a solid 3.3% annual pace in the first quarter of 2007 before slowing slightly this spring. The spending pace is expected to pick up speed in the second half of this year and maintain about a 3.0% stride during the remaining years of the forecast horizon. With energy prices stabilizing, wage gains have been outpacing inflation. As a result, real disposable income growth is expected to accelerate from 2.6% in 2006 to 3.2% in 2007. After this year, real disposable income is anticipated to advance about 3.6% annually. The improving income situation should enable households to increase both their spending and savings. Last year, the U.S. personal savings rate sank to -1.1%, which was its lowest level since the Great Depression. Given the projected decline in home prices, consumers are likely to reel in their spending, causing the personal savings rate to return to positive territory in 2008. Consumer spending will also be dampened by the anticipated slump in home sales that will curb expenditures on furniture, appliances, and decorating. Housing markets should stabilize in 2008 and then gradually recover, causing spending on home goods to pick up in the last two years of the forecast. In fact, higher gains in stocks, bonds, mutual funds, and retirement fund assets, helped raise household net worth 7.4% in 2006. Unfortunately, net worth, weighed down by the declining housing asset values, will rise just 0.4% this year. However, gains will accelerate after 2007.

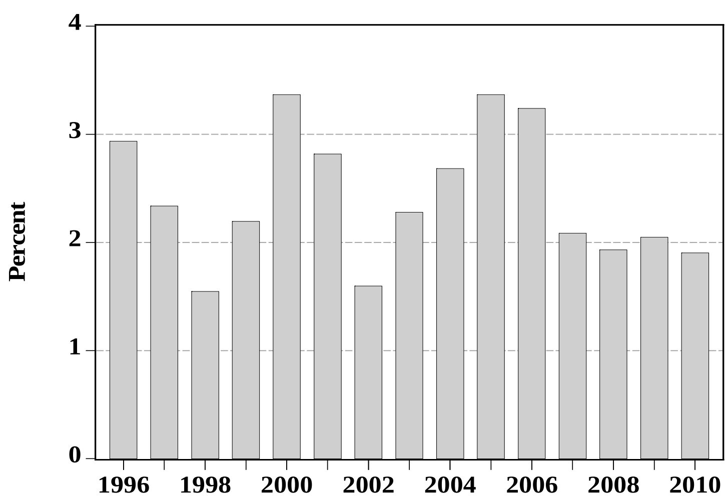
U.S. Real Consumption and Disposable Income Growth



Source: Global Insight

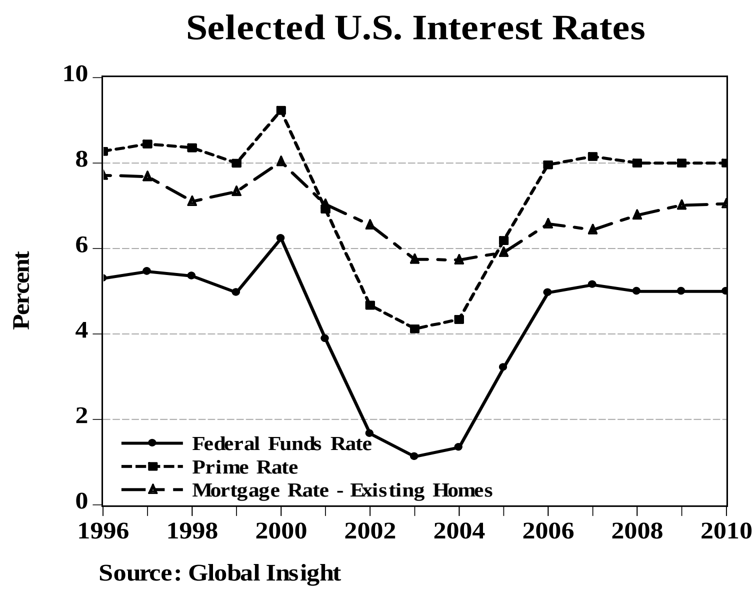
Inflation: While recent price increases have not been large enough to set off alarms, the heat from glowing inflation embers has not gone unfelt either. One inflation measure, the personal consumption expenditure index, has recently risen above the Federal Reserve's 2-percent "comfort zone" threshold a few times, no doubt causing the monetary authority to oil up its inflation-fighting machinery in case prices continue increasing for an extended period. The central bank's job is being made difficult by data which often present mixed signals caused by the volatility of energy prices. The last quarter of 2006 serves as a good example. In last year's terminal quarter the annualized core (all items less food and energy) inflation rate was 1.9%, which was near the Federal Reserve's upper limit. However, overall consumer prices actually declined at a 2.1% annual pace during the quarter. This decline was caused by the 53.0% annualized decline in the energy commodity component of the consumer price index. Of course, the

Consumer Price Inflation



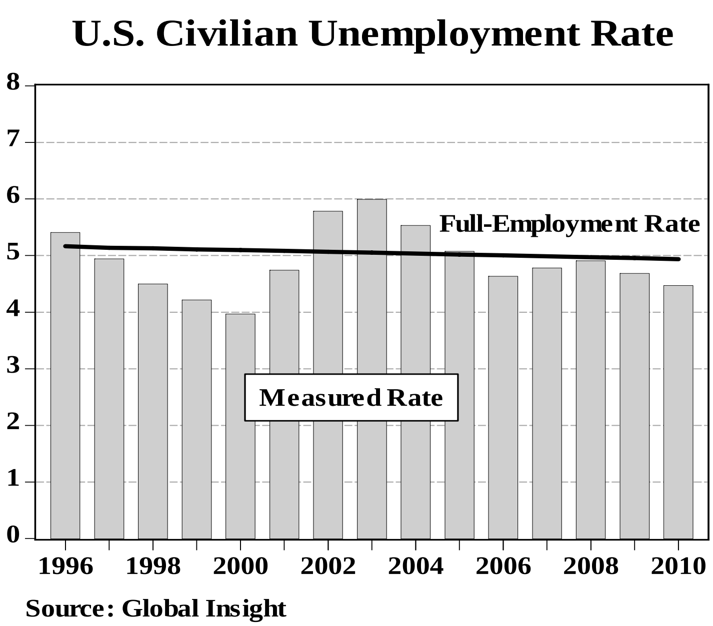
Source: Global Insight

energy price pendulum swings both ways. For example, energy prices soared at a 72.0% annual rate just two quarters earlier before plunging in the last quarter of 2006. It appears energy price oscillations should dampen over time, but at relatively high levels. After averaging just under $61 per barrel this year, the West Texas Intermediate crude spot price is forecast to rise to between $61 and $62 per barrel in 2008 and hover near that price through the remainder of the forecast. However, leveling energy prices will not extinguish inflation because the tight labor market is expected to continue exerting upward pressures on wages, and wages are a major contributor to the core inflation rate. An improving labor productivity outlook will take some, but not all, of the edge off these wages pressures. Nonfarm business output per hour is forecast to advance 1.4% this year and about 2.0% annually thereafter. Despite this steady productivity growth, wage costs accelerate from 3.1% this year to 3.5% in 2010. The core inflation rate averages about 2.2% per year. Forecasted overall consumer inflation is 2.1% in 2007, 1.9% in 2008, 2.0% in 2009, and 1.9% in 2010.



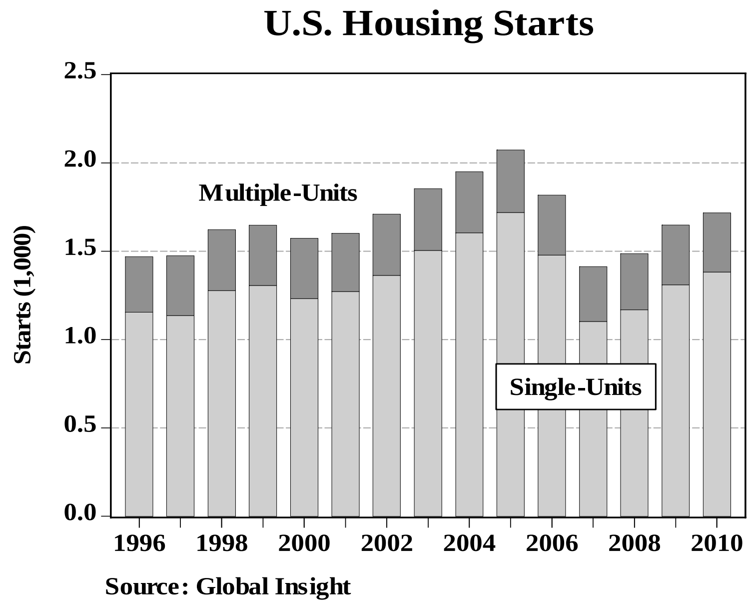
Financial Markets: Recent setbacks in financial markets should not derail future U.S. economic growth. U.S. and other global markets experienced sharp increases in volatility this winter. Several seemingly unrelated factors within several days precipitated a dive in global equity prices. The three main factors were: Chinese government efforts to regulate securities markets and tighten liquidity; concerns the U.S. economy may be weaker than reported; and some ill-timed remarks by Alan Greenspan regarding recession risks in the U.S. The Chinese stock market plunged 9% due to the latter two factors. This drop occurred against a backdrop of concerns of historically high Chinese equity valuations and wild market swings. However, these events should have little material impact on the growth in the economy. The U.S. equity markets and economy have shrugged off a number of fairly major shocks, but signs of stress became apparent in February 2007 with a pullback in business investment, a persistent inventory overhang, and tightening mortgage lending standards. Services will not be totally immune from the weak housing and automotive sectors, but services should be resilient enough to help keep the economy afloat. Former Federal Reserve Chairman Alan Greenspan's comments referred to the fact that the U.S. business cycle expansion is under duress. Specifically, risk of a recession later in 2007 was therefore higher than they were in the previous two years. Greenspan later clarified his recession comments by saying the probability of U.S. recession risk was one-third. Greenspan-fueled worries of an imminent U.S. recession are clearly overblown. The Federal Reserve's tightening policy which started in June 2004 has successfully slowed growth and reined in inflation. It has also provided the central bank with increased latitude with which to set future policy, not that this seems necessary. Barring a sharp increase in recession risks, the Federal Reserve is expected to remain on hold for several more months. It is anticipated the central bank will lower its federal funds rate by 25 basis points to 5.0% on August 7, 2007. This move should keep the real funds rate (nominal federal funds rate less the inflation rate) from moving much above 3.25%. The yield curve is expected to invert during the first half of next year, but it does not portend a recession.

Business Investment: Real business investment helped prop up the U.S. economy last year. In 2006, this component of GDP expanded about 7.2%, or more than twice as fast as total national output. Investment benefited from the healthy spending for nonresidential structures. However, after experiencing healthy growth last year, real private investment is expected to grow more slowly over the forecast period. One of the reasons for this slowing is the reduced prospect for nonresidential spending. It is still expected to post strong numbers in this year's first half, but it will fall victim in the second half of this year to the side-effects of the housing slump. Spending on commercial property in particular will be a drag on broader building growth. Unfortunately, other components of investment are not anticipated to grow fast enough to offset the slack of slowing property investment. Real spending on software and equipment retreated at a 4.8% annual rate during the fourth quarter of 2006 and is forecast to shrink another 2.3% in the first quarter of 2007. The situation does improve over time, however. The release of Microsoft Vista provides a small first-quarter boost to spending on computers and software. Weighed down by weak growth during these two quarters, real spending on equipment and software is projected to increase just 1.3% in 2007. Real spending expands faster after this year, however, thanks to continuing improvement in technology. The current forecast shows real nonresidential investment slowing this year, but improving thereafter. Total real business investment grows 3.0% in 2007, 4.2% in 2008, 5.2% in 2009, and 4.4% in 2010.

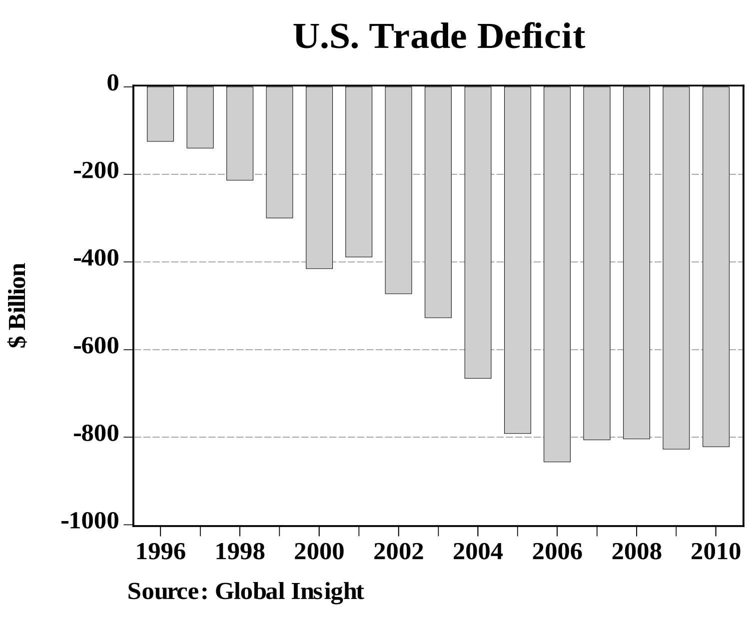


Employment: The U.S. labor market is healthy. The United States Department of Labor reported in the March 2007 *Employment Situation Report* that seasonally-adjusted payroll employment rose by 180,000 to 137.6 million jobs. This increase follows gains of 162,000 jobs in January and 113,000 jobs in February. On a year-over-year basis, total nonfarm employment was about 2 million higher in March 2007 than in March 2006. The strong March report caught many economists by surprise because they believed weaknesses in the housing market would dampen construction employment. However, construction improved by 56,000 jobs in March, mostly offsetting its decline of 61,000 jobs in February. Part of this swing was weather induced, so interpreting this data is challenging. To get a better idea of the construction component's health, one should review it over a longer time period. Historical statistics show construction employment has shown no net growth since peaking last September. Since then, nonresidential construction has been expanding, but not enough to offset residential construction job losses. Manufacturing employment continued its long slide, shedding another 16,000 jobs in March, so that there were 109,000 fewer jobs than in March 2006. Despite these setbacks, the U.S. unemployment rate has remained below 5.0% since the beginning of 2006. Looking forward, U.S. nonfarm employment is expected to increase 1.2% this year, 1.0% next year, and 1.4% in both 2009 and 2010. The civilian unemployment rate should remain at levels consistent with full employment over the forecast period.

Housing: Housing remains the biggest drag on economic growth. However, getting a precise read on this situation is challenging because recent data have fluctuated wildly, making it hard to separate underlying trends from weather-related noise. November 2006 was the 14th warmest winter on record (1895-2006) and December 2006 was the 4th warmest December, while January 2007 was near normal. As a result, houses that would have been started in the first quarter of 2007 were started in the fourth quarter of 2006. This explains why the number of housing starts jumped in November and December of last year, and then plunged in January of this year. Despite its February rally, housing starts remained below December's showing. This does not mean the housing sector is prospering. For example, December's strong starts number was down about 18.0% compared to December 2005. In fact, it is estimated the housing downturn shaved 1.2 percentage points off GDP in the fourth quarter of 2006 and is forecast to reduce it an average of one percentage point over the first half of this year. No analysis of the housing sector is complete without discussing the impacts of the subprime mortgage meltdown. The signs of subprime market stress are evident on an almost daily basis. Recently, New Century Financial Corporation, the second-largest subprime lender, filed for bankruptcy. Over the past few months, over two dozen lenders have suffered the same fate, sought buyers, or ceased operations. Meanwhile, both delinquency rates and foreclosures have risen sharply. For example, delinquency rates in the subprime market rose to 13.3% in the fourth quarter of last year. In comparison, the prime-loan delinquency rate is only 2.6%. Foreclosure rates in the same quarter were 0.54% for subprime loans and 0.24% for prime loans. Subprime loans account for 13-14% of all outstanding mortgages. The subprime adjustable-rate mortgages (ARM) are the biggest worry. About two-thirds of these ARMs will "reset" in the next two years, raising monthly mortgage payments, which points to more foreclosures down the road. Problems in the subprime market, as well as tightening lending standards, will curb the demand for housing over the next year. The number of U.S. housing starts are projected to drop 22.2% this year to 1.413 million units, the lowest level since 1995. It should also be noted national housing prices are expected to decline in both 2007 and 2008. Respectable income growth and household formations should help this sector grow in the remaining years of the forecast, so that by 2010 the number of housing starts is 1.717 million units, which is about where it was in 2002.



International: The recently released current-account deficit number for 2006 belies the improving trade situation. The 2006 current-account deficit came in at $857 billion, which was significantly higher than the previous year's $792 billion deficit. However, the annual tally masks the improvement that occurred late last year because of falling oil prices. The fourth quarter 2006 shortfall was just $783 billion, following a $918 billion annualized deficit in the previous quarter. The huge swing from the third to fourth quarters highlights the current account's vulnerability to oil price swings. The trade deficit shrank from $806 billion in the third quarter of 2006 to $714 billion in the fourth quarter. The fourth quarter trade



rebound added 1.6 percentage points to overall GDP growth. The last time trade added so much to growth was when a huge quarterly improvement was bracketed by two sizable deteriorations that netted out to no change. No relapse has appeared or is expected this time, however. Instead, the progress of the fourth quarter will continue. The U.S. trade deficit (balance-of-payment basis) is expected to improve by about $100 billion from $765 billion in 2006 to $689 billion in 2007. The trade deficit is anticipated to shrink more slowly after next year, reaching $626 billion in 2010. Despite the improvement in trade, the current-account deficit is not projected to decline steadily over the next few years because net income payments abroad eclipse payments. As a result, the current-account balance deficit swings from $857 billion in 2006 to $806 billion in 2007, $804 billion in 2008, $827 billion in 2009, and $822 billion in 2010.